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Making the draft Law on Joint Stock Companies more workable for enterprises and better aligned to international benchmark and EU legislation

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Caveat

The views expressed in this report do not necessary reflect the position of the European Commission

All the findings in this report are based on the English version of the draft law on JSC. This translation has been made available by the Commercial Law Center (USAID Project) to which we express our deep gratitude. Nevertheless, that is not an authenticated translation and despite the quality of the performance of the translator, some discrepancies between the original Ukrainian version of the text and the English version, might have been introduced.

LIST OF ABBREVIATIONS

AGM	Annual General Meeting
EC	European Community
EU	European Union
JSC	Joint Stock Company
PCA	Partnership and Co-operation Agreement
SDLA	State Department for Law Approximation

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Making the draft Law on Joint Stock Companies more workable for enterprises and better aligned to international benchmark and EU legislation

Introduction

The creation of a favourable environment for enterprises is a key priority agreed by Ukraine and the EU in the EU-Ukraine Action Plan of 2005[1].

The elimination of inconsistencies in the existing Economic and Civil codes and the convergence of company law with relevant international and EU rules and standards are part of the key principles to be taken into account in a new Joint Stock Company law.

The last draft Law on Joint Stock Companies prepared under the leadership of the State Commission of Securities and Stock Market has been endorsed by the Cabinet of Ministers of Ukraine with minor changes. Finally, the draft law has been registered at the Verkhovna Rada (No 3177) on 15 February 2007.

Amendments will be introduced during the process of formal enactment.

The current report does not intend to comment on the draft law, article by article. Therefore more detailed observations could be further developed on specific provisions.

The purpose of this contribution is twofold:

- First, it is to examine the extent to which the current draft law takes into account the best practice of corporate governance and addresses the EU legislation accordingly.

- The second objective is to determine areas for improvement to make the draft law more workable and more responsive to the needs of enterprises.

For this exercise, the relevant background of the EU legislation consists mainly of provisions contained in the following Directives:

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[1] See, in particular, the following priorities in the ENP-AP:
(20) Undertake consistent and far-reaching structural reform programme to further consolidate the functioning of market economy.
– Adopt a new Joint Stock Company law improving the definition of the responsibilities of directors, managers and shareholders' meetings, strengthening disclosure requirements, and increasing the protection of minority-shareholder's rights.
(33, d) Company law:
– Improve the competence and independence of auditors.
– Converge with and ensure effective implementation of key principles in relevant international and EU rules and standards.
– Create the unified state register of legal persons and physical persons-entrepreneurs companies and ensure publication of information on the organisation and financial situation of companies. Define and ensure effective activity of an administrative authority, which ensures the control of the incorporation of a company or the legality of certain acts.
– Encourage adoption of a code on corporate governance.

- First Council Directive 68/151/EEC for equivalent safeguards in company law (compulsory disclosure of information)
- Second Council Directive 77/91/EEC on safeguards in respect of the formation of public limited companies, maintenance and alteration of their capital
- Third Council Directive 78/855/EEC on mergers of public limited liability companies
- Sixth Council Directive 82/891/EEC concerning the division of public limited companies
- Directive 2004/25/EC on takeover bids

To a limited extent, this report refers also to Directives on corporate accounting (Directives 78/660/EEC, 83/349/EEC, 2006/43/EC and 2006/46/EC). Some of their provisions have implications within the scope of the draft law on JSC.

Finally, we draw also on the Proposal for a Directive on the exercise of voting rights by shareholders of listed companies[2]. The Council of the EU and the European Parliament have reached a common position on this proposal. The text will be part of the acquis communautaire in the coming months.

As regards references to other international benchmark, the analysis of the draft law gives some resonance to corporate rules in the UK and the French legislation, the German Corporate Governance Code and the OECD Principles of Corporate Governance.

The analysis follows two complementary approaches:

- The normative approach to compare the set of norms in the draft law against the benchmark of another set of rules is developed in **Part I** of this report.

- The functional approach, to assess the results liable to be achieved by the draft law against the background of the objectives assigned to this regulatory activity of the State, is contained in **Part II** of this report.

[2] Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC - COM(2005) 685 final of 05.01.2006.

I –Legal appraisal of key provisions of the draft law on JSC

1. Scope

The draft law covers all corporate rules applicable to JSC, both public and private, equivalent to the types of companies in the EU Member States where the unique consideration for forming the company is the capital subscribed by the members of the association and not the persons that are members of that association[3]. For example, public and private JSC in Ukraine may correspond to the following forms of companies in the EU:

- Ireland and the UK:
  - public company limited by shares,
  - public company limited by guarantee and having a share capital;
  - companies incorporated with limited liability (private limited companies)
- France, Belgium, Luxemburg: Société Anonyme
- Germany and Austria: Aktiengesellschaft
- Italy: Societa per Azioni
- Spain: Sociedad Anonima
- Portugal: Sociedade anonima de responsabilidade limitada;
- Finland and Sweden: Aktiebolag

The scope of the draft law includes companies of which securities are admitted to trading on a regulated market[4]. Nevertheless it is not the purpose of the draft law to address transaction of securities on the stock exchange market.

Rules governing companies that provide financial services (bank, insurance, other financial institutions) are also covered by the draft law. However national and EU requirements specific to the taking up and pursuit of the related business are subject to other pieces of national legislation [Art. 1(2)]. As a result, exemptions for the above activities which sometimes are laid down in the general EU legislation on company law are not envisaged in the current draft law[5].

Specific rules for state-owned companies and companies in the process of privatisation are not repealed. They will supersede the rules contained in the general legal framework for JSC [Art. 1(3)].

Apart from the criterion of the offering of placement of shares in the public (not defined in the draft law) almost the same corporate rules apply to public and private JSC (see, section 3 of Part II of this report).

One may think that public JSC would be “open” companies while private JSC would be “closed” companies. Maybe the practical operation of the related types of companies will ensure this distinction but from the legal point of view, the requirements set out in the draft law are confusing (see, section 2.2.6 below).

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[3] See the definition of “joint stock company” in the Companies Act 2006 (UK):
For the purposes of section 1040 (companies authorised to register under this Act) “joint stock company” means a company:
(a) having a permanent paid-up or nominal share capital of fixed amount divided into shares, also of fixed amount, or held and transferable as stock, or divided and held partly in one way and partly in the other, and
(b) formed on the principle of having for its members the holders of those shares or that stock, and no other persons.

[4] They are called “listed” companies in the text of the draft law.

[5] See for example, notion of net assets for investment companies, laid down in Article 20 of Directive 77/91/EEC.

Contrary to the prevailing situation in the EU Member States where the concept of offering placement of shares in the public does not entail systematically the admission to the stock exchange (for examples, shares may be traded through the intermediation of banks), the draft law sets out that public JSC must have their securities admitted to official listing on a stock exchange [Art. 23(1)]. It is not specified that the stock-exchange is the Ukrainian one. It is not specified as well which are the consequences with regard to the validity of the creation of the company where the application for admission to official listing is rejected.

2. Formation of JSC

2.1. Capital

2.1.1. Minimum capital to be subscribed

Article 13(1) of the draft law, dealing with statutory capital of JSC (circa EUR 170,000 at this date, according to the exchange rate between HRN and EUR) meets the requirements of the Article 6 of the Directive 77/91/EEC on the minimum capital to be subscribed (EUR 25,000) but does not seem to do it within the proper manner. In the draft text, the calculation is made on the ground of a variable (legal minimum wages) that is adjusted every quarter by the law on the State Budget. Furthermore the draft law does not provide for the practical measures which could flow from this adjustment[6].

In the EU Member States, conditions of minimum capital are more stringent for public JSC than for private JSC[7].

In addition it is observed that the draft law does not make the distinction between subscription of shares and payment of shares. Placed shares are to be fully paid [article 22 (2)]. As a result, the definition of statutory capital [article 1(17)] does not have to rely on the concepts of "subscribed capital" and "paid up capital" existing in the EU legislation. It is not mandatory to reproduce in the national legislation the option offered in the EU legislation (and widespread in all the EU Member States) to delay the payment of shares for a certain fraction of the share capital but this facilitation is helpful for the creation of a number of enterprises, especially SMEs.

2.1.2. Assets included in the capital

Article 7 of Directive 77/91/EEC which prohibits including in the subscribed capital assets that take the form of the performance of work or the supply of services is reflected in Article 22 of the draft law.

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[6] For example, among other problematic issues it should be envisaged to deal with the following:
- amount to be taken into account at the date of the signature of the charter by the founders or at the date of registration;
- procedure to increase the capital, where by reason of the legal adjustment of the minimum wages, the statutory the capital of the company becomes insufficient;
- amount taken into consideration to implement the clause on loss of capital.

[7] In the UK, there is no minimum share capital for private limited companies and public limited companies must have an authorised share capital of at least £50,000. In France, the minimum subscribed capital for private JSC is EUR 36,000 and EUR 225,000 for public JSC.

By contrast, Articles 10, 10(a) and 10(b) of the same Directive are not addressed (principle of evaluation by independent experts of the assets comprising the consideration other than in cash, with limited exemptions).

2.2. Shares

2.2.1. Categories of shares

The share capital is formed by common shares (with voting rights in the General Meetings) and preferred shares (Art. 19). Preferred shares which grant certain rights listed under Article 25 cannot exceed 25% of the share capital. This point is not regulated by the EU legislation but the related provisions in the draft law are fully compatible with the best practices in the EU Member States.

All shares have to be registered. There is no explicit mention that shares might be issued either to the holder's name or to bearer but the draft law does not indicate the appropriate means of registration since the relevant provisions are contained in the law No 710/97 on the National Depositary System and Electronic Circulation of Securities in Ukraine.

2.2.2. Price of the shares

Article 21 of the draft law is compatible with the provisions of Article 8 of Directive 77/91/EEC for it lays down the principle that shares cannot be issued at a lower price than their nominal value or their accountable par and that traders in securities may pay less. Other considerations contained in this article 21 (placement at the price established by the "constituent agreement" and placement on the occasion of mergers or divisions) might be questionable, as useless in the related legal contexts where there is no real placement as such.

2.2.3. Shares held by one person

Article 5 of the Directive 77/91/EEC (shares held by one person where there should be several shareholders) is not reproduced in the draft law but does not need to be because the draft law allows for one single shareholder.

2.2.4. Payment of shares

Article 9 (part of the price of shares to be paid at the time of incorporation) and Article 12 of the Directive 77/91/EEC (obligation for the shareholders to pay up their contributions except in case of reduction of capital) are not mirrored in the draft law but do not need to be because the draft law considers only paid up shares.

2.2.5. Shares subscribed by the company

The basic prohibition contained in Article 18 of the Directive 77/91/EEC is not reproduced in the draft law.

2.2.6. Transfer of shares

In principle all shares are fully transferable except where the charter of a private JSC provides for a right of pre-emption to transfer the shares of a shareholder to third-parties (Art. 6 of the draft law).

This principle seems to comply with the rules and the practice in the EU Member States. By nature, the transfer of shares of public JSC cannot be subject to the exercise of a right of pre-emption (except in case of increase in capital)[8].

Actually, the use of the wording “may” instead of “shall” in the two paragraphs of Article 6 of the draft law is rather confusing and could lead to the interpretation that the introduction of a right of pre-emption for the transfer of shares is allowed whatever the type of JSC, either private or public.

2.3. First steps before acquiring legal personality

2.3.1 Approval of draft charter and first corporate bodies by the first shareholders

In the draft law, the same rules apply to the measures taken by the founders before the first statutory meeting of a JSC either public or private. At the end of the day, the founders will have to approve unanimously the draft charter[9] (“constituent agreement”) and to designate the first corporate bodies (Articles 8 to 10).

It is observed that the “constituent agreement” between natural persons is authenticated by a Notary [Art. 8(3)]. Surprisingly this measure is not extended to legal persons.

To make the rules more understandable and more practical for businesses, it would be advisable to better detail the consecutive steps of the formation of a JSC for each type of company. In the same vein, the draft law could deal as well on the specific measures to collect the funds before the statutory meeting and to lock up the capital paid-up (in a specific Bank account or with a notary) till the registration of the company.

It should be specified also that the first statutory meeting of a private JSC will approve at least the first supervisory board and the first executive body and not necessarily all the corporate bodies. Except, where the charter of the company provides otherwise, maybe it is not yet the appropriate time to designate corporate bodies such as the Audit Commission (“Inspection Commission” in the draft law) and the Corporate Secretary as far as the creation of those ancillary bodies is necessary. Some experience of the functioning of the company might help to reach an informed decision on those designations.

2.3.2. Information contained in the instrument of incorporation

Article 12 of the draft law does not explicitly address the requirements of Articles 2 and 3 of Directive 77/91/EEC (information contained in the instruments of incorporation or other documents subject to mandatory publication).

Actually, this article 12 does not list (even, by simple reference) other provisions contained in the draft law and designed for the same purpose[10] and does not resume either provisions

[8] See, for example, Art. L 228-23 of the French Commercial Code.

[9] It is assumed that the non binding “constituent agreement” aimed at in the text is actually a contractual arrangement between the founders. It is assumed as well that, practically, this “constituent agreement” comprises the draft charter and signature of a statement made by each founder regarding the amount of the share capital they subscribe.

[10] See, for example, the provisions on the duration of the company, under the article 3(3) of the draft law.

contained in other pieces of national legislation[11]. Some improvements of legal drafting are recommended to this end but it seems that, within the overall legal framework, the requirements of the Directive are fulfilled except some uncertainty on the definition of the objects of the company. Objects of the company[12]are never mentioned in the text or indirectly through the article 32 of the draft law concerning the powers of the General Meeting under the wording "defining main areas of JSC operations".

2.3.3. Liabilities incurred before the authorisation to commence business

Article 3(1, j) and Article 4 of the Directive 77/91/EEC are fully taken into account in the Article 11(1 and 2) of the.draft law. It has just to be expected that the formulation used in the draft law is consistent with the provisions that address the same issue in other pieces of national legislation[13].

3. Transparency of main operations affecting the formation and the course of business of JSC

In the draft law, there is only one provision whose purpose would be to comply indirectly with the requirements of the Directive 68/151/EEC on compulsory publication of information: Article 79(1) of the draft law (information of creditors in writing in case of termination through merger, division, transformation, takeover and publication in the "official printing edition").

Another provision of the draft law deals with publication in the "official press edition". But this Article 34(1) concerning the notice for the organisation of the general meeting where there are more 1,000 shareholders, albeit being justified to ensure, among other means, a wide participation in the general meeting, has no correspondence in the EU legislation.

Actually it appears[14] that other pieces of national legislation achieve the objectives of transparency sought by the Directive 68/151/EEC.

Articles 2 (operations and documents subject to disclosure) and 3 (Central Commercial Register) of the Directive are reportedly transposed in the law of 15 May 2003 on State Registration of Legal Entities and Natural Persons-Entrepreneurs" (articles 11, 16, 17, 20 and 22 of this law).

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[11] According to the Review 2006 of the SDLA on the state of play of the law approximation it is assumed that some of the missing mentions with regard to the implementation of Articles 2 and 3 of the Directive are reflected in the law of 19 September 1991 on Business Associations (articles 4, 37, 51, 65, 67 and 76) and in the Civil Code (article 88).

We note also that the requirement of the Directive concerning the "identity of the natural or legal persons by whom or in whose name the instruments of incorporation have been signed" is met by the law of 15 May 2003 on "State Registration of Legal Entities and Natural Persons-Entrepreneurs" - constituent documents have to be signed by the founders or their authorised representative and signatures have to be authenticated by a notary.

[12] Essential information to determine the validity of commitments towards third parties. However, in the recent reform of the UK legislation on company law (2006), where objects of the company are not written in the memorandum of association, they are deemed to be unrestricted.

[13] In the Review 2006 of the SDLA on the state of play of the law approximation it is reported that the related provisions of the Directive 77/91/EEC are transposed in the Commercial Code, the law on licensing of certain economic activities and in the Civil Code.

Article 7 of the Directive is also mirrored under the Article 11 of the draft law on JSC (liability of founders of a JSC).

[14] Review 2006 of the SDLA on the state of play of the law approximation.

This law of May 2003 meets also the EU requirements concerning the certification in due legal form of instruments of constitution and their amendments (Art. 10 of Directive 68/151/EEC) and the quality of persons in charge of disclosure formalities (Article 5 of Directive 68/151/EEC).

Nevertheless, it seems that are still missing in the national legal framework provisions to fulfil the requirements of the following provisions of Directive 68/151/EEC:

- Article 4 (statement of particulars in letters and order forms or any other medium)[15]
- Article 6 (penalties in case of omission from commercial documents of compulsory particulars)
- Articles 8 and 9 (company bound by acts of persons before their formal appointment and by acts of the organs of the company relied on as against third parties)
- Articles 11 and 12 (cases and consequences of nullity of companies)

4. Shareholders' rights

4.1 Payment of Dividends

The requirements of Article 15 of the Directive 77/91/EEC (amount of the distribution to shareholders) are covered by Article 30 of the draft law with some variations:

- "Owned equity" in the draft text seems to have the same meaning as "net assets" in the EU legislation[16], and "legal reserve" corresponds to the same concept in the EU and Ukrainian legislation. What is difficult to understand is the additional condition inserted in the draft law where it is question of "liquidation value of preferred shares" exceeding their nominal value.
- The reference point to make the calculation is the closing date of the last financial year in the EU legislation. This reference is omitted in the draft law.
- Article 15(1, c) of Directive 77/91/EEC is not mirrored[17].
- The irregular distribution to be returned by shareholders (Article 16 of Directive 77/91/EEC) is not envisaged in the draft law.

Furthermore, it is observed that the draft law does not envisage the situation of the payment of interim dividends. Should they be authorised, the conditions set out in the Directive should be reflected in the law.

It has to be noted also that the satisfaction of requests of shareholders pursuant to the mandatory redemption of shares is considered by the draft law as an element of calculation to check whether the payment of dividends is possible. The Directive does not deal with this situation. It speaks only of "losses brought forward" and "sums placed to reserve". Limitation to the distribution of dividends may be more stringent in the draft law than in the EU legislation but that is not the proper way to attract investors.

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[15] The requirements are not reflected in the Article 76 of the draft law (on the information provided by the company) or elsewhere in the text.

[16] See Art. 13(2) of the draft law.

[17] "The amount of a distribution to shareholders may not exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes".

4.2. Exercise of voting rights in AGM and other general meetings of shareholders

4.2.1. Calling of the General meeting

Beside the shareholders (natural persons and representatives of legal persons), representatives of the employees of the company may also participate in the General Meetings, under the condition, that the charter of the company provides for such a representation of the employees (Art. 33 of the draft law). This representation of the workers drawn on the best practice of corporate governance is welcomed.

Entitlement to participate and vote in the General Meeting derives from the files handled by the institutions which manage the “Depositary System” in Ukraine. At this stage, it is difficult to assess to which extent the functioning of this depositary system regulated by the law No 710/97 is compatible with the requirements of the Proposal for a Directive on the exercise of voting rights by shareholders[18] (as amended by the European Parliament). The objective of the article 7 of this Proposal for a Directive is to abolish all forms of share blocking to replace them by a record date system. Whatsoever, it seems already relevant to set out in the draft law the date taken into consideration to close the list of shareholders that have access to the General Meeting. This “record date” should not be earlier than 30 calendar days before the general meeting[19].

4.2.2. Notice of the General Meeting

Individual notices are sent to each shareholder, in principle not later than 30 days before the General Meeting or less, in the case of an extraordinary General Meeting (Art. 34 of the draft law). This provision complies with the requirement of Article 5(1) of the Proposal for a Directive on the exercise of voting rights by shareholders. In the draft EU legislation, it is question of “not later than on the twenty-first day before the day of the meeting”.

It is also praiseworthy to note that where the company has more than 1000 shareholders, there is an additional publication in the Official Gazette.

With regard to the content of the notice [Art. 34 (3) of the draft law] mentions are not exactly the same as those laid down[20] in the Proposal for a Directive on the exercise of voting rights by

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[18] Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC - COM(2005) 685 final of 05.01.2006.

[19] See, for more details, Art. 7(3) of the Proposal for a Directive on the exercise of voting rights by shareholders, as amended by the European Parliament.

[20] Article 5(3)
The convocation referred to in paragraph 1 shall at least :
a) indicate precisely when and where the general meeting is to take place, and the proposed agenda for the general meeting;
b) contain a clear and precise description of the procedures that shareholders must comply with in order to be able to participate and to cast their vote in the general meeting. This includes information concerning:
i) the rights available to shareholders under Article 6, to the extent that those rights can be exercised after the issuing of the convocation, and under Article 9, and the deadlines by which those rights may be exercised; the convocation may confine itself to stating only the deadlines by which those rights may be exercised, provided it contains a reference to more detailed information concerning those rights being made available on the Internet site of the company;
ii) the procedure for voting by proxy, notably the forms to be used to vote by proxy and the means by which the company is prepared to accept electronic notifications of proxy appointments; and
iii) where applicable, the procedures for casting votes by correspondence or by electronic means

shareholders, but equivalent in pursuing the same objective. What is missing is mainly the reference to information posted at the Internet Site of the company[21] and a clear description of procedures (limited to some issues in the draft law).

Furthermore, there is a provision in the draft law that foreign investors will especially appreciate. Companies in which 100% of the shares are held by foreigners may organise General Meetings abroad.

4.2.3. Information provided to shareholders

Paragraph 1 of Article 35 of the draft law provides for the right to inspect document at the place of the company. That is probably related to other documents than those subject to communication, indicated in the paragraph 2.

Communication of documents to shareholders will be made not later than 30 days before the General Meeting, where the company has less than 100 shareholders. This time-schedule sounds appropriate. What is strange is that the procedure of information will be decided by the General Meeting for companies with more than 100 shareholders. At least to cover the period before the related General Meeting, it would be relevant to refer to the procedure to be necessarily set out in the charter of the company.

A Code of Corporate Governance (encouraged by the EU-Ukraine Action Plan) would extend the information to other stakeholders, even those who are not invited to vote a the General Meeting.[22]

4.2.4. Items on the Agenda of the General Meeting

The draft agenda initially approved by the Supervisory Board (Article 36 of the draft law) can be amended by shareholders (Article 37). The right for any shareholder to propose items on the agenda and to table draft resolutions within a certain time-limit (15 days at the latest before the date of the General Meeting) is recognized. Moreover, it is mandatory to include the related draft resolutions where, the relevant shareholder holds a minimum stake in the share capital (set out at 5% in the draft law). In parallel, the applicable procedure is well described.

All the provisions above comply with the article 6 of the Proposal for a Directive on the exercise of voting rights by shareholders. Just limited improvement should be sought to better ascertain the idea that the rights referred to in article 37 of the draft law will be exercised sufficiently in advance of the date of the General Meeting, to enable other shareholders to receive or have access to the revised agenda or the proposed resolutions ahead of the General Meeting[23].

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c) where applicable, state the record date referred to in Article 7(2) and explain that only those who are shareholders on that date shall have the right to participate and vote in the general meeting;
d) indicate where and how the full, unabridged text of the documents and draft resolutions referred to in points (c) and (d) of paragraph 4 may be obtained;
e) indicate the address of the Internet site on which the information referred to in paragraph 4 will be made available
.

[21] Having in mind that the draft law provides for the dissemination of information by Public JSC, through the operation of a website [Art. 76(4)], this shortcoming could be easily addressed.
[22] In the German Code of Corporate Governance (Points 2.3.1 and 2.3.2), the Management Board shall also publish reports and documents, including the Annual Report on the company's Internet site together with the agenda. Furthermore, the information is made available not only to shareholders but also shareholders' associations and financial services providers, who, in the preceding 12 months, have requested such notification.

[23] See, Article 6(4) of the Proposal for a Directive on the exercise of voting rights by shareholders.

4.2.5. Participation in the General Meeting

The draft law (Art. 38) authorises proxy voting with reasonable conditions to check the regularity of the appointment of the proxy holder. That is a step in the right direction even if the detailed requirements laid down in Articles 10 and 11 of the Proposal for a Directive on the exercise of voting rights by shareholders are not yet met.

Voting by correspondence is not envisaged by the draft law and is not prohibited either[24].

Lastly, we note that no rules are set out to allow voting upon instructions where financial institutions hold securities of various shareholders in the so-called "omnibus accounts"[25].

As a whole, the draft law does not give a significant room to Information Technologies to organise General Meeting.[26].

4.2.6. Right to ask questions

While the Article 9 of the of the Proposal for a Directive on the exercise of voting rights by shareholders sets out rules on the proper way to question the management at General Meetings, the draft law does not provide for the mechanism of oral questions and does not endorse either a system of questions/answers (FAQ) on the website of the company.

4.2.7. Quorum and votes

The principle of one share one vote for all common shares is laid down in the draft law (Art. 24 and 25). Consequently it seems that multiple-vote securities[27] are not recognised in the Ukrainian legislation. In this regard, there is no uniformity in the legislation of the EU Member States.

Furthermore, the principle of separate votes on issues that are relevant for holders of preferred shares (listed under Article 25, paragraph 5) with specific conditions of quorum and majority is set out in the draft law and is compatible with the EU legislation.

Election of the members of the Supervisory Board by cumulative voting[28] is rather original (optional for private JSC and compulsory for public JSC). This clause imported from the practice authorised in some States in the USA, allows a better representation of minorities.

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[24] The vote by correspondence is authorised by the article 12 of the Proposal for a Directive on the exercise of voting rights by shareholders.

[25] See, in this regard, Article 13 of the Proposal for a Directive on the exercise of voting rights by shareholders.

[26] The use of e-communications is encouraged by the Proposal for a Directive on the exercise of voting rights by shareholders. In the German Code of Corporate Governance (Point 2.3.4) it should be made possible for shareholders to follow the General Meeting using modern communication media (e.g. Internet).

[27] See, definition in Directive 2004/25/EC on takeover bids: "multiple-vote securities shall mean securities included in a distinct and separate class and carrying more than one vote each".

[28] All the voting rights granted to any shareholder to elect each member of the board may go to one or several members of the board.

More than 50% of the shareholders need to be present or represented at a General Meetings (AGM and extraordinary General Meetings) to constitute the quorum to proceed to vote. This quorum is the same to call a second meeting where the quorum was not met on the occasion of the previous meeting (Art. 46).

Firstly, while the quorum set is adapted to decisions of mergers, divisions, takeover bids, amendments to the charter, early dissolution, increase and reduction in capital, limitations of right of pre-emption it is extremely high as far are concerned agendas of General Meetings that do not imply fundamental changes in the company. For example, in the UK the normal quorum is constituted by 2 shareholders, in France, by 20% of voting shares[29] and in Belgium or Luxembourg, there is no ordinary quorum. Secondly, since the quorum set for the second call of the General Meeting is not below the threshold required for the first call, there is no reason to predict the feasibility of the General Meeting after the second call. That would be a serious cause of interruption of the functioning of the corporate rules of the company, especially, where there is no provision in the draft law to authorise a court to circumvent that situation[30].

Simple majority is the basic rule for adoption of resolutions by General Meetings, but there is a need to meet a majority of 3/4 for fundamental changes such as:

- Objects of the company and amendments to the charter (including the type of the company)
- Placement of shares
- Increase of capital by increasing the nominal value of shares
- Reduction of capital, where it is not the consequence of the cancellation of shares
- Conclusion of a major transaction
- Non-exercise of the right of pre-emption during the placement of shares, when the shares are not offered to the public.

In addition, the charter of companies with less than 25 shareholders may specify rules for super-majority vote in all matters except those enumerated under the second paragraph of Article 41(3) of the draft law.

In the French law (Art. 1836-2 of the Civil Code for association with civil purpose and Art. L 225-96 of the Commercial Code for business association), whatever the provisions in the charter of the association, the General Meeting is not entitled to increase the commitments of any of the members of the association without his/her consent. That rule implies that unanimity is required where, for example, there is an increase of capital (against cash) with increase of the nominal value of the shares or where the JSC is transformed into an unlimited partnership. It seems that this level of protection of shareholders does not derive from general provisions in the Civil or Commercial Code of Ukraine and is not subject to specific provisions in the draft law. The draft law envisages indirectly a couple of situations where the initial commitments of shareholders in the instruments of incorporation would be altered (but not necessarily more stringent) without their assent. In this case, the concerned shareholders would have the right to claim the compulsory redemption of their shares (Art. 66).

4.2.8. Polls and related procedures

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[29] This quorum is applicable to AGM but for extra-ordinary General Meetings it is 25%.

[30] In France, there is no condition of quorum for the second call of an AGM. The case law has recognised the validity of the practice that consists to already organise the possible second call in the notice sent to the shareholders on the occasion of the first call. See also, Article 306 of the Company Act 2006 (UK) on the power of court to order meeting.

Articles 42 to 45 of the draft law provide for very detailed measures concerning the adoption of the resolutions at the General Meetings (mentions on the ballot papers, establishment of a special commission ("Tabulation Commission") to scrutinise the poll, records of votes, minutes of the General Meeting).

The draft law only envisages resolutions taken pursuant to a poll. That is compulsory for public JSC but, since the draft text use the wording "may" in the article 42(1), it seems that the adoption of resolutions on the show of hands is permitted in the private JSC as far as it is allowed by the charter.

Concerning the counting of votes, Article 44 of the draft law meets to a large extent the requirements of Article 14 of the Proposal for a Directive on the exercise of voting rights by shareholders. Just is missing the indication of the number of votes validly cast and the requirement to publish on the Internet, within 15 calendar days following the General Meeting, the results of the votes on each resolution tabled at the General Meeting.

4.3. Protection of minority shareholders from controlling shareholders

4.3.1. Acquisition of a significant block of shares – takeover bids

Articles 62 and 63 of the draft law under the chapter XI "Acquisition of a significant block of company's shares" are addressing issues that are covered by the Directive 2004/25/EC on takeover bids as far are concerned public JSC[31].

Articles 62 and 63 of the draft law seem to apply both to public and private JSC. One may discuss the point whether or not to extend to private JSC the same requirements as those of public JSC. That is more a question of practice on the domestic market than a legal issue. The legal concern is to examine to which extent the draft law reflects the requirements of the Directive 2004/25/EC.

The definitions laid down in the draft law that refer to "Person acting jointly" [article 2(11)] and "control" [article 2 (6)] would deserve a better formulation. In the Community law, the notion of "control" appears under the article 24(a) of the Directive 77/91/EEC (acquisition and holding of shares by a group of companies) and the provisions of the Directive 2004/25/EC on takeover bids (for the protection of minority shareholders) where it is developed through the notion of "persons acting in concert"[32].

To define the notion of "control" without taking the risk to omit specific situations, it is suggested to use a more generic wording which will consider the person who, directly or indirectly, holds a specific percentage of voting rights in the company, giving him/her control of the company.

As for the substantive rules, the draft law adopts the principle of the notification of the offer and specifies the related deadlines which are consistent with the requirements of the Directive

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[31] It has to be noted that this Directive applies to the acquisition of "all or some" of the securities and that the offeror may be a natural person or a legal person.

[32] Article 1(d) of the Directive: "natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid."

2004/25/EC. The draft law specifies as well the content of the offer document with indications that are globally equivalent to those more detailed of the article 6(3) of the Directive.

The right of sell-out the shares is contained in the draft law but not the parallel right of squeeze-out[33] granted to the offeror by the EU law.

Other principles and provisions of the Directive 2004/25/EC are not considered in the draft law. They relate in particular to the following:

- Board of the company whose securities are the subject of a bid, acting in the interests of the company as a whole.
- Natural or legal person making a bid in position to fulfil in full any cash consideration.
- Designation of the authorities competent to supervise bids (article 4 of the Directive). In the case of the draft law, the State Commission of Securities and Stock Market is notified by the offeror but there is no indication on the power of this institution to exercise an effective control on the operation).
- Equitable price offered to minority shareholders with possible intervention of the Supervisory Authority[34] [Art. 5(4) of the Directive].
- Publication of detailed information on companies (Art. 10 of the Directive).
- Employees' rights (articles 6, 8 and 14 of the Directive).
- Obligations of the board of the offeree company:
    - Prior authorisation of the general meeting of shareholders called at short notice,
    - Drawing up and making public a special report (Art. 9 of the Directive).
- Other rules to be envisaged by the national legislation to govern the conduct of bids (lapsing of bids, revision of bids, competing bids, disclosure of the results of bids, irrevocability of bids and conditions permitted).

It is observed also that the draft law seems to envisage cash payments [Article 63(5)] while the Directive states under Article 5(5): “by way of consideration the offeror may offer securities, cash or a combination of both”.

In addition, Articles 62 and 63 of the draft law fall short from the rules applied in the EU Member States with regard to the disclosure of information on the shares held by individual shareholders of public JSC. While the draft law sets a threshold of 50% of the voting rights to disclose the related information to the company and to the State Commission of Securities and Stock Market, there is a dozen of progressive thresholds in the French legislation and at least five in the German Code of Corporate Governance (5, 10, 25, 50 or 75%). Multiplication of thresholds ensures a better transparency of companies listed at the stock-exchange market.

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[33] Right of a majority shareholder to require the remaining minority shareholders to sell him their securities at a fair price.

[34] In Ukraine, the Supervisory Authority is the State Commission of Securities and Stock Market.

4.3.2. Major transaction

In the draft law, a "major transaction" may have important consequences on the structure of the capital because it can open the right of a mandatory redemption of shares of shareholders who voted against the related resolution at the General Meeting (article 66).

The definition of a "major transaction" given under the article 2(4) of the draft law (setting out a threshold of 10%) is contradicted by the definition given under the article 68 (setting out two thresholds - 10 % and 25%)[35]. Whatever this discrepancy which probably flows from the different purposes of the two articles in question, the main remark is to underline that in the draft law the reference point to calculate the amount of the transaction is rather vague. The notion of "value of assets" should be replaced by accounting concepts such as "net current assets" or maybe "total assets less current liabilities" as they are written in the last annual balance sheet.

4.3.3. Compulsory redemption of shares

Article 66 of the draft law contains provisions on the compulsory redemption of shares in certain circumstances. That is probably a core issue for the authors of the draft law but also the most problematic part of the new rules on JSC.

Article 66 of the draft law applies both to private and public JSC and in a number of situations that go far beyond the usual practice of JSC in the EU Member States and the requirements of the EU legislation.

The EU legislation regulates the compulsory **purchase** of shares only in the context of a **takeover-bid** involving a **public JSC** and where a bid has been made to all the shareholders of the offeree company (Directive 2004/25/EC).

Articles 19, 20 and 35 of Directive 77/91/EEC deal also with **public JSC** permitted to **redeem** its own shares. In particular the redemption is authorised where shares are acquired "by virtue of a legal obligation or resulting from a court ruling for the protection of minority shareholders in the event, particularly, of a merger, a change in the company's object or form, transfer abroad of the registered office, or the introduction of restrictions on the transfer of shares"[36].

To say the least, the draft law disregards the provisions (and does not anticipate the consequences) of Article 35(c) of Directive 77/91/EEC that specify that in the case of total or partial redemption of the subscribed capital without reduction of the latter "shareholders whose shares are redeemed shall **retain their rights in the company**, with the exception of their rights to the repayment of their investment and participation in the distribution of an initial dividend on unredeemed shares".

In the EU Member States, the issue of compulsory redemption of shares merely **derives from the charter** of the company[37]. The objective of the national laws and the EU legislation is to limit the possibilities for a company to acquire (purchase or redemption) its own shares.

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[35] The major transaction is adopted by the supervisory board where the amount of the transaction corresponds to 10 to 25% of the assets of the company and by the General Meeting where the supervisory board failed to approve this transaction or where the amount of the transaction is above 25% of the assets of the company.

[36] Article 20(1,d).

[37] See, for example, Articles 684 to 689 on redeemable shares, in Companies Act 2006 (UK).

Actually, the cases of compulsory redemption of shares enumerated under the article 66 of the draft law should be limited to resolutions of General Meetings restricting the transfer of shares.

The protection of minority shareholders is a legitimate objective which could be attained through more proportionate means and the draft law already contains specific measures to this end. It should not have the result to be detrimental to the conduct of the business of the company, where finally, with the threat to exercise the right to the redemption of their shares, the minority shareholders would take the lead to decide or not of operations crucial for the survival or the development of the company.

The concept of "abuse of majority" exists in foreign legislations (in civil and common law). In countries of civil law, it is linked to the general concept of "abuse of a right". That is the case, for example where the resolutions of the General Meetings go against the interest of the company as a whole. In this situation, any shareholder (very often it is a group of shareholders) may institute proceedings before the courts against the company and/or the shareholders that took benefit from the challenged resolutions.

Concerning the various cases of compulsory redemption of shares in the draft law we note in parallel:

- The termination of the company by merger is governed by other provisions of the draft law that specify a simple majority to approve the merger. A super-majority could have been laid down in the text.

- Increase and decrease in the statutory capital have already to be approved by a majority of 75% of the share capital.

- The conversion of a public company into a private company could be assimilated to a restriction to trading the shares (case of compulsory redemption of shares). But, let us imagine the more realistic situation that this conversion is imposed by the State Commission of Securities and Stock Market through the radiation of the official listing, without a resolution adopted by the General Meeting. In this case, the strict application of the provisions of the draft law will not open the way to the compulsory redemption of shares. Moreover, it is observed that the more plausible situation of the conversion of a private company into a public company may raise the issue of the compulsory redemption of shares in several EU Member States. That is the case in France where the majority shareholder holds more than 95% of the share capital.

5. Structure, duties and responsibilities of the corporate bodies

5. 1. Supervisory and managerial bodies

5.1.1. Co-existence of the unitary and the two-tier board systems

Throughout the articles of the draft law, supervisory and managerial bodies of the JSC are identified with the wording "Supervisory Board" and "Executive Body" but those expressions deriving form the two-tier board system have to be considered as equivalent to "Board of Directors" and "Chief Executive Officer", in the unitary board structure. In fact, the draft law

offers the option to establish either a two-tier or a unitary board system[38]. Moreover, the executive body can be collegial or composed of one person.

Both systems are developed across the EU Member States and lead to comparable results.

5.1.2. Common features with board structures of companies established in the EU and specificities

The description of tasks and responsibilities of the Supervisory Body and the Executive Body shows that the two corporate bodies play the same role than their counterparts in the EU.

The similarities extend to all matters regarding nomination and dismissal of the members of the supervisory and managerial bodies, size of the supervisory body, role of the chairpersons of the two corporate bodies, regularity of the meetings of the supervisory body, prohibition of simultaneous mandates in the supervisory body and the managerial body and a number of other rules regarding the functioning of the corporate bodies.

It has to be noted, in particular, that the draft law sets out the duty of confidentiality and the obligation of non-disclosure of commercial secrets[39].

Other issues will be subject to provisions set out in the charter or subordinate by-law. Whatsoever, there will be still some room to develop other rules (mainly for listed companies, but not exclusively) in future Code(s) of Corporate Governance such as, for example:

- Accountability of the corporate bodies to promote the interests of the company.
- Criteria for the election of the members of the Supervisory Board so as to ensure their independent advice (availability, required knowledge, expert experience).
- Transparency for the nomination of new members of the Supervisory Board.
- Opening up of the Supervisory Board to a proportion of non-controlling shareholders selected on the ground of their qualification and their ability to have an objective judgement on corporate affairs.
- Transparency of insider information to prevent market manipulation.
- Non-competition obligation and prohibition of bribes received or offered.

Some singular provisions in the draft law deserve specific comments.

Firstly it has to be mentioned a probable mistake. The draft law places under the exclusive competence of the Supervisory Board the nomination and the dismissal of the members of the Executive Board and its chairperson [Art. 50(2, paragraphs 9 and 11)] while that is also the exclusive competence of the General Meeting [Art. 32(2, paragraphs 18 and 19)][40].

Secondly, it is observed that the participation in the meetings of the managerial body is quite open. It involves the auditor, a representative of the body representing collectively the workers (some kind of work council which is not so developed in Ukraine) and any shareholder holding

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[38] This option exists as well in the French legislation but in practice, only enterprises with worldwide dimension or companies listed at the stock-exchange market tend to adopt the two-tier board system.

[39] The related obligations apply to all company's officers [Art. 60(2)].

[40] In the German Corporate Governance Code, the Supervisory Board appoints and dismisses the members of the Management Board.

more than 1% of the share capital (the text use the word “stock” which is not defined in the draft law). Representatives of trade union or other representatives of the workers that have signed a collective agreement may also participate in the meetings of the Supervisory Board with consultative voice.

The participation of the statutory auditor is surprising. This may hamper its independence and would be very costly for the enterprise except where the participation of the auditor is limited to meetings regarding the approval of annual accounts.

Last remarks relate to the following:

- Companies with 10 shareholders or less are not obliged to elect a board. In this case the functions of the board are carried out by the General Meeting.

- No age limit is specified for the members of the Supervisory Board

- Circulation of the information is facilitated by the presence of the members of the Supervisory Board in the meetings of the Executive Board.

- Article 60(1) of the draft law provides for incompatibilities with the functions carried out by company’s officers. Where those incompatibilities relate to the existence of official functions in the Institutions or in the Public Administration of Ukraine, they would be better placed in another piece of legislation to be applicable to other forms of companies or economic activities.

5.1.3. Remuneration and compensation schemes of the members of Supervisory Board and the Executive Body

A number of provisions of the draft law refer to contracts concluded between the company and individual members of the main corporate bodies (Supervisory Board, Executive Body and Audit Committee) and the remuneration or compensation granted accordingly: Article 32(2 sub-item 20), Article. 49(3), Article 50(2, sub-item 10), Article 56(5), Article 60(4) and Article 71(3).

The nature of the commitments between the company and the company’s officers mentioned above does not seem to be settled. Contracts are identified as “labour” or “civil” agreements or sometimes as “legal agreements”.

More seriously, Article 51(2) of the draft law states that after their nomination, the members of the Supervisory Board must have been contracted before exercising their function (“civil contract” and “legal agreement”). This kind of measure misread the nature of the functions of the members of the Supervisory Board. It has to be underlined that members of a Supervisory Board in a company exercise a corporate mandate. Where, some of them are effectively involved in other technical or managerial functions in the enterprise, they may be contracted additionally with a labour contract or a service contract. This distinction is valid in civil[41] and in common law[42].

[41] See, for example, Art. L225-22 of the French Commercial Code which provides also that labour contracts between the company and the board members cannot be conclude with more than 1/3 of the members of the board.

[42] See, for example, sections 188 and 227 of the Companies Act 2006 (UK) on long-term services contracts (to be approved) and Directors’ service contracts.

This issue may be linked with the termination of the mandate of the members of the Supervisory Board. Where it is admitted that the end of the mandate of a member of the Board has to be differentiated from the termination of any other service or labour contract concluded by the member of the Board and the company, the draft law has to set out the proper provisions to govern this situation[43].

It is possible that the authors of the draft law intended to reserve a special scheme of benefits or incentives for the members of the Supervisory Board. Article 32(2, sub-items 20) seems to introduce some distinction between contract and compensation. Whatsoever, we think that the draft law could already lay down the principles applicable to special schemes of compensation for the members of the Supervisory board and, possibly, for the members of the Executive Body. Further on, the draft law could refer to the implementation of the principle through the voluntary adoption of a Code of Corporate Governance[44] or in the charter of the company.

In the German Corporate Governance Code, the compensation system for the members of the Supervisory Board[45] is designed as follows:

- Specified by resolution of the General Meeting or in the charter of the company.
- Based on responsibilities of the members of the Supervisory Board, the economic situation and performance of the enterprise.
- Reported individually in the Corporate Governance Report (mandatory in the EU legislation for listed companies).

Similar rules should apply to the remuneration of the members of the Executive Body to be decided by the Supervisory Body (based on performance assessment and situation in peer companies, with fixed and variable elements and other incentives such as stock-options, pension benefits and "Golden parachute" after the termination of the function).[46]

5.2. <u>Audit Committee ("Inspection Committee") and other operations of audit</u>

A real importance is devoted to the scrutiny and the monitoring of the financial and economic situation of the company (Articles. 71 to 74). The draft law does not hesitate to superpose two levels of control in private or public JSC with more than 100 holders of common shares and opens the way to additional controls on ad-hoc basis. Provisions address as well the independence of the auditors.

The internal level of financial control is the responsibility of the Audit Committee ("Inspection Committee" in the text) whose members are nominated by the General Meeting[47] with application of the system of cumulative voting. Those members cannot be at the same time members of the Supervisory Body or the Executive Body.

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[43] See, for example, Section 215 of Companies Act 2006 (UK) on "Payments for loss of office".

[44] Such a Code of Corporate Governance is already mentioned in the EU legislation on corporate accounting.

[45] Point 5.4.7 of the Code.

[46] In the French legislation, this kind of remuneration, as far as it corresponds to an effective work, is assimilated to a salary for the purposes of taxation and social security legislation but that does not entail that the relationship between the company and the recipient of the remuneration is governed by the rules applicable to labour contracts.

[47] In Germany, the Audit Committee is generally set up by the Supervisory Board. The nomination by the General Meeting is liable to reinforce the independence of the Audit Committee.

Among other competences, the Audit Committee is entitled to propose items on the Agenda of General Meetings, to call an extra-ordinary General Meeting and, where the charter or the General Meeting provide for it, to participate in meetings of the Supervisory Board and Executive Body.

Implementing provisions on composition, nomination[48] and additional competences of the Audit Committee, have to be included in the charter or decided by the General Meeting, but the draft law does not indicate the proper means of enforcement.

The role of the Audit Committee is to monitor ("inspect" in the text) the financial and economic situation of the company and to submit at least an annual report on the quality of the annual accounts and compliance with legal requirements in financial and accounting matters.

The external level of financial control is primarily the responsibility of the statutory auditor which has to be appointed according to requirements of the national legislation on corporate accounting[49]. Provisions under Article 73(1) of the draft law show that the independence of the auditor is taken into account. However, the subject-matter would gain to be developed in the charter or resolutions of the General Meeting[50].

Apart from the scrutiny deriving from legal requirements, the auditor will have to review the data subject to the examination of the Audit Committee. We think this additional duty is not so relevant, as far as the Directive 78/660/EEC on the annual accounts of certain types of companies is reflected in the Ukrainian legislation. Actually, Article 46 of this Directive which specifies the contents of the annual report is rather comprehensive[51].

The draft law foresees that other external financial controls could be carried out on the initiative of the Audit Committee or on request of shareholders holding a certain proportion of the share capital (more than 5% of the share capital or, for the related cost to be supported by the company, at least 10%).

5.3. <u>Other corporate bodies: permanent and ad-hoc Committees, Company Secretary</u>

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[48] The German Corporate Governance Code recommends that the chairperson of the audit committee should have specialist -knowledge and experience in the application of accounting principles and internal control processes.

[49] The degree to which the national legislation is compatible with EU requirements on corporate accounting does not fall within the scope of this report. The EU requirements on statutory audit of accounts and on the approval of persons responsible for carrying out the statutory audits ares contained in Directive 2006/43/EC.

[50] See, for example, Point 7.2 of the German Corporate Governance Code:
Prior to submitting a proposal for election, the Supervisory Board or, respectively, the Audit Committee shall obtain a statement from the proposed auditor stating whether, and where applicable, which business, financial, personal and other relationships exist between the auditor and its executive bodies and head auditors on the one hand, and the enterprise and the members of its executive bodies on the other hand, that could call its independence into question. This statement shall include the extent to which other services were performed for the enterprise in the past year, especially in the field of consultancy, or which are contracted for the following year. The Supervisory Board shall agree with the auditor that the Chairman of the Supervisory Board will be informed immediately of any grounds for disqualification or impartiality occurring during the audit, unless such grounds are eliminated immediately.

[51] It includes in particular: "fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces, "both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters"

The possibility offered to the Supervisory Board to set up permanent and ad-hoc Committees is a classic practice in the two-tier board system. The draft law lays down the principle and refers to implementing provisions in the charter or other subordinate instruments (by-law). It is recommended to include in the principle that the Members of the Committees are nominated on the ground of their expertise to handle complex issues.

As regards the designation of a Corporate Secretary, Article 54(4) of the draft law is unclear (even in Ukrainian language). Two interpretations are possible. One the one hand the understanding would be that the designation of a Corporate Secretary is mandatory and that the chairperson of the Board will propose the name of the person to be designated. On the second hand, the interpretation would be that the designation of a Corporate Secretary relies on the willingness of the chairperson of the Board to proceed to the appointment if need be.

It seems that the idea of the Corporate Secretary has been imported from the UK. Actually in the UK a JSC could be formed with one Director and one Company Secretary and very often the function of Company Secretary was out-sourced. Private JSC in the UK will no longer be obliged to have a Company Secretary since the reform of the corporate law in 2006.

It is expected that, after some rewording of Article 54(4) of the draft law, in order to ensure legal certainty, the institution of Corporate Secretary will be made mandatory only towards public JSC.

5.4. Liability for damages

Article 61 of the draft law establishes a joint civil liability of all members of Supervisory Board, Executive Body and Audit Committee to compensate "losses caused to the company by their actions or inactivity"[52].

That is only one aspect of liability for damages. The scope of Article 61 covers only damages sustained by the company and overlooks civil consequences of losses suffered and costs incurred by shareholders or creditors originating from negligence, default in complying with corporate rules and breach of duties.

However, it is interesting to note that the Audit Committee is also liable for damages. In the case of a public JSC, it would be needed to extend expressly this joint responsibility in the drawing up and publishing of financial statements[53].

6. Conflicts of interest

6.1. Acquisition by the company of assets belonging to founders of the company, shortly after the incorporation of the company

[52] See, the same idea expressed differently under the Point 3.8 of the German Corporate Governance Code.
"The Management Board and Supervisory Board comply with the rules of proper corporate management. If they violate the due care and diligence of a prudent and conscientious Managing Director or Supervisory Board member, they are liable to the company for damages".

[53] Requirement of the Directive 2006/46/EC that lastly amended Directives on corporate accounting.

Article 11 of Directive 77/91/EEC specifies that the acquisition of assets belonging to founders of the company should be subject to a specific scrutiny, mention in the Commercial/Company Register and publication in the Official Gazette. Those requirements apply where the transaction takes place within at least 2 years from the commencement of the company and where the amount of the transaction corresponds to 1/10 of the subscribed capital (or above).

There are no such provisions in the draft law.

6.2. Interest of a related-party in a transaction concluded by the company

To address the same concept as "affiliated persons" in the draft law [Art. 2(1)] the wording in the EU terminology is "related party" of which the definition is given in the EC Regulation No 1606/2002 on adoption of certain International Accounting Standards. This latter definition recognised internationally (part of IAS 24) should be taken as a reference in the draft law on JSC.

Article 69 of the draft law introduces the duty to inform within 3 days the Executive Body on the details of the transaction where the related party holds at least 25% of common shares of the company (unless the charter provides otherwise). Thereafter, it seems that the role of the Executive Body is to produce a report because no procedure of approval is foreseen. That is not a requirement in the EU legislation[54] but an international benchmark[55].

As a whole, the draft law is not very talkative on infringements to specific provisions, but in this particular case, breach of duty in respect of disclosure of information is subject to compensation for damages and/or annulment of the transaction by courts (Art. 70).

7. Maintenance and alteration of capital

7.1 Loss of the subscribed capital

Provisions of Article 13(3) of the draft law go beyond the requirements of Article 17 of the Directive 77/91/EEC. The provisions of the draft law tackle any loss while the EU legislation

[54] The EU legislation addresses this issue at the stage of the production of the annual accounts. The Directive 2006/46/EC has added a new paragraph to article 43 (content of the notes on the accounts) of Directive 78/660/EEC to provide information on "the nature, business purpose and amount of any transaction entered into by the company with related parties, where that transaction is material and has not been concluded under normal commercial conditions".

[55] See, for example, some requirements in the German Corporate Governance Code:
Point 3.9: Extending loans from the enterprise to members of the Management and Supervisory Boards or their relatives requires the approval of the Supervisory Board.
Point 4.3.4: All members of the Management Board shall disclose conflicts of interest to the Supervisory Board without delay and inform the other members of the Management Board thereof. All transactions between the enterprise and the members of the Management Board as well as persons they are close to or companies they have a personal association with must comply with standards customary in the sector. Important transactions shall require the approval of the Supervisory Board.
Point 5.5.2: Each member of the Supervisory Board shall inform the Supervisory Board of any conflicts of interest which may result from a consultant or directorship function with clients, suppliers, lenders or other business partners.
Point 5.5.3: In its report, the Supervisory Board shall inform the General Meeting of any conflicts of interest which have occurred together with their treatment. Material conflicts of interest and those which are not merely temporary in respect of the person of a Supervisory Board member shall result in the termination of his mandate.

covers only "serious loss" (loss higher than half of the subscribed capital). Liquidation of JSC on this ground might be frequent.

7.2. Company acquiring its own shares

7.2.1. Scope and procedure

Articles 64 and 65 of the draft law reproduce a very pale version of the provisions of Articles 19 to 24(a) and Article 39 of the Directive 77/91/EEC.

The principle that conditions of the redemption of shares are set out by resolution of the General Meeting is similar in both legislation but the conditions under which the operation of redemption is authorised are not the same.

We note in particular the following gaps regarding the prohibition to redeem the shares:

- The draft law makes reference to the notion of insolvency and "own equity" (net assets) of the company but does not consider the calculation of "shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf"[56].

- The ceiling is 10% in the Directive and 20% in the draft law (article 65).

- The draft law does not consider that "acquisition shall not prejudice the satisfaction of creditors' claims".

- The consequences of the cancellation of shares are not foreseen (article 16 of the draft law governs only the procedure).

- The time limit to dispose acquired shares as a result of the operation of the redemption of shares is not determined.

Among other disparities we note also:

- The compulsory disclosure of the notification of redemption in the Unified State Register and in the Official Gazette is forgotten.

- The fundamental principle of equal treatment of all shareholders who are in the same position is disregarded. Article 64(2, 2nd paragraph) introduces the idea that the redemption of shares could benefit only to individual shareholders (and not in proportion of the number of shares of the same class held by the shareholders).

7.2.2. Financial support of the company for the purchase of its shares by third-parties

The prohibition of loans made by the company (or guarantee of loans) for the acquisition of the shares of the company by a third party [Art. 22(5) of the draft law] reflects to a large extent the requirements of Articles 23 of the Directive 77/91/EEC. Nevertheless Article 22(5) of the draft

[56] The purpose of this calculation is to determine whether the acquisition by the company of its own shares would have such an effect on the net assets that the net assets would become lower than the subscribed capital plus the reserves not subject to distribution.[Art. 19(1,b), read in conjunction with Art 15(1 a and b) of Directive 77/91/EEC].

law should be further developed to make it clear that this prohibition aims at financial support either direct or **indirect**. On this occasion, Article 22(5) of the draft law could express unambiguously that the prohibition to provide a guarantee extends to the acceptance by the company of its own shares as a security[57] (Art. 24 of Directive 77/91/EEC).

It has been reported by the SDLA[58], that Articles 22 to 24 of Directive 77/91/EEC are transposed in the law of 23 February 2006 on Securities and Stock Market (article 41). All stakeholders would benefit from a reconciliation of the provisions contained in the draft law and the provisions of the law of 2006 on Securities and Stock Market regarding company acquiring its own shares. This operation would ensure the consistency between the two texts and would be the occasion to introduce new rules to tackle the issue of subscription, acquisition and holding of shares by a group of companies (in relation to Article 24(a) of Directive 77/91/EEC).

[57] Within the meaning of an instrument to secure the collection of a debt.

[58] Annual Review 2006 of the SDLA on the state of play of the law approximation.

7.3. Increase in capital

The short article 14 of the draft law sets out some principles, but other provisions are supposedly contained (currently or in the future?) in a normative act of the State Commission for Securities and Stock Market.

In this context it is expected that the secondary legislation will take stock of the requirements of the articles 25 to 29 of the Directive 77/91/EEC with regard to the following:

- Publication at the Unified State Register and in the Official Gazette of the resolution of the General Meeting and the same publication after the completion of the operation.
- Expert report on shares issued for a consideration other than in cash.
- Separate vote where there are several classes of shares.

The right of pre-emption mentioned briefly in the article 14 is governed by the article 26 of the draft law. This article is rather confusing. It covers together the right of pre-emption on the occasion of the sale of shares to third-parties and the right of pre-emption in case of increase in capital against cash consideration.

As far as increase in capital is concerned, the provisions of the article 29 of the Directive 77/91/EEC are not fully addressed:

- The notice sent to each shareholder should be also published in the Official Gazette.
- In the context of the presentation of the resolution to be adopted by the General Meeting so as to restrict the right of pre-emption, the Supervisory Board should produce a special report to justify the decision.
- The related resolution of the General Meeting should be published in the Unified State Register and in the Official Gazette.

7.4. Reduction in the subscribed capital

Article 15 of the draft law on the reduction in the subscribed capital does not cover all the legal issues addressed by the articles 30 to 38 of the Directive 77/91/EEC. A normative act of the State Commission for Securities and Stock Market is supposed to fill the gap[59].

Worth noting that the protection of the rights of creditors [Art. 15(2) of the draft law] is already in line with the requirements of Article 32(1, paragraph 1) of the Directive 77/91/EEC but paragraph 2 of the same article[60] and article 32(2)[61] are not transposed.

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[59] For example, rules have to address the reduction in the subscribed capital by compulsory withdrawal of shares.

[60] Member States shall lay down the conditions for the exercise of the right provided for in the first subparagraph. In any event, Member States shall ensure that the creditors are authorised to apply to the appropriate administrative or judicial authority for adequate safeguards provided that they can credibly demonstrate that due to the reduction in the subscribed capital the satisfaction of their claims is at stake, and that no adequate safeguards have been obtained from the company.

[61] The laws of the Member States shall also stipulate at least that the reduction shall be void or that no payment may be made for the benefit of the shareholders, until the creditors have obtained satisfaction or a court has decided that their application should not be acceded to.

8. <u>External restructuring of company through merger, division and assimilated operations</u>

8.1. Common provisions and overall remarks

Articles 77 to 84 of the draft law provide for common or individual provisions to cover certain operations of restructuring.

Headings of the articles of this chapter XVI dealing with "Termination of a JSC" are ambiguous and, in the absence of classic definitions, the text under the headings has to be read carefully to tentatively determine the scope of the substantive rules.

With some degree of uncertainty, our understanding is as follows:

- Article 78 on "Agreement on Merger (takeover)"and "Plan of Division" deals with rules applicable to "companies participating in termination" (probably with regard to the situation of the company being acquired or divided or which transfers its assets) and "company participating in reorganisation" (probably with regard to the situation of the recipient company) and seems to cover all operations of divisions and mergers without any distinction concerning the result of the operations (transfer to one or several companies or creation of one or several companies).

- Article 80 on "Merger" sets out rules applicable where at least two companies merge to create a new company.

- Article 81 on "Takeover" sets out the rules where one or several companies are being acquired (merger by acquisition).

- Article 82 on "Division" covers the division of one company by creation of at least 2 new companies.

- Article 83 on "Spinning-off" covers the transfer of assets of a company to create one or several companies without termination of the transferor company (against shares of the company to which assets are transferred).

- Article 84 on "Transformation" sets out rules applicable indistinctly to companies which will cease to exist (probably after their division or their acquisition but without indication concerning the result of the operations - transfer to one or several companies or creation of one or several companies). This article might cover also division by acquisition, which is not covered elsewhere in the chapter XVI of the draft law.

This lay out of the chapter XVI of the draft law is rather confusing. Despite a number of similarities of the rules applicable to mergers and divisions, the chapter XVI should have been articulated on the one hand, through the basic distinctions of the EU legislation (merger by acquisition, merger by formation of a new company, division by acquisition and division by creation of new companies) and on the second hand, through the variants of the operations above. This revision would enhance clarity and legal certainty of the substantive rules.

It has to be reminded that the EU legislation has been inspired from the model of the legislation of the EU Member States and that the lay out of the legislation of the Member States concerning mergers and acquisitions follows the logical classification of operations as it is mentioned above.

As it stands now, the chapter XVI of the draft law has the effect that similar situations are treated by different or overlapping rules.

In addition, it has to be observed that all operations of restructuring covered by the draft law aim at operations between JSC themselves. Although, the scope of the related EU legal framework is limited to this kind of operations, the national legislation of EU Member States is also developed towards operations between JSC and other forms of companies/natural persons.

8.2. Mergers and operations considered as equivalent

Mergers of JSC are subject to requirements contained in Directive 78/855/EEC. It flows from the previous considerations (in the section 8.1 above) that it is dubious that this Directive has been taken as a reference point to develop the provisions of the draft law. However there are some elements of convergence we are going to underline below.

Definition of merger

As said before, the definition of merger by acquisition and merger by formation of a new company are not expressly included in the draft law but it seems they are contained in other pieces of national legislation [62].

[62] According to the SDLA Annual Review 2006 on the state of play of the law approximation, definitions contained in the Directive 78/855/EEC are mirrored in the article 59(1 and 3) of the Commercial Code and in a Regulation approved by Decision No 221 of the State Commission for Securities and Stock Market of 30 December 1998.

Terms of merger

The draft law lays down the principle of the drawing up of the draft terms of a merger. To some extent, the specifications of this document are compatible with the requirements of the Directive 78/855/EEC[63] but they fall short from addressing all the requirements[64].

The publication of the draft terms of merger and time-limit to do so are comparable in the draft law and the EU legislation. Formally, the draft law forgets to mention the publication at the Unified State Register beside the publication in the Official Gazette.

Approval of the merger

The draft law reflects also the requirement concerning the approval of the merger by the general meeting of each of the merging companies. Moreover, the draft law makes use of the exemption provided for in the article 27 of the Directive (where the acquiring company holds already at least 90% of the securities of the company being acquired) but in this case the requirements of the Directive are shortened.

Special report by management bodies of merging companies

The "detailed written report" aimed at in Article 9 of the Directive is reflected in the draft law with the looser wording "explanation for shareholders" and there is no mention of explanations to be provided to shareholders on "the setting out of the legal and economic grounds for shareholders, in particular the share exchange ratio and the description of any special valuation difficulties which have arisen".

Report by independent experts

In line with the EU legislation, the draft law requires the production of a report by independent experts on the draft terms of merger. Unfortunately this requirement applies only to JSC with more than 100 shareholders [Art. 78(3) of the draft law]. In addition, the content of the statement of the expert(s)) is reflected in a draft law with a global wording less detailed than in the Directive and the right of the expert(s) to obtain information is not reflected at all.

Right of shareholders to inspect documents

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[63] Fully in line with the provisions of article 5 (2, a and b) of the Directive where it is specified that "Draft terms of merger shall specify at least: (a) the type, name and registered office of each of the merging companies; (b) the share exchange ratio and the amount of any cash payment.
More evasive with regard to the provisions of article 5 (c and d) of the Directive which specify that the draft terms of merger will include "(c) the terms relating to the allotment of shares in the acquiring company; (d) the date from which the holding of such shares entitles the holders to participate in profits and any special conditions affecting that entitlement.

[64] In particular the following provisions of article 5 (e,f,g) of the Directive are not taken into consideration:
"(e) the date from which the transactions of the company being acquired shall be treated for accounting purposes as being those of the acquiring company;
(f) the rights conferred by the acquiring company on the holders of shares to which special rights are attached and the holders of securities other than shares, or the measures proposed concerning them;
(g) any special advantage granted to the experts referred to in Article 10 (1) and members of the merging companies' administrative, management, supervisory or controlling bodies.

While Article 11 of Directive 78/855/EEC provides for detailed measures concerning the right of shareholders to inspect a series of documents, the draft law grants to shareholders the "opportunity" to obtain an opinion of an independent expert [Art. 78(3)]. The conditions of selection and remuneration of the expert are not laid down.

Date on which a merger takes effect and compulsory disclosure of information

Article 17 of the Directive 78/855/EEC concerning the date of the completion of the merger is implemented by Article 77(7) of the draft law, which refers to two entries in the Unified State Register (termination and registration). However the article 77(7) of the draft law does not appear to totally match, even indirectly, all the requirements for the publication of merger prescribed by Article 18 of the Directive. The compulsory disclosure necessitates also a publication in the Official Gazette.

Other rules in the Directive 78/855/EEC not yet captured in the draft law

It is observed that the draft law passes over totally in silence the following issues:

- Rights of the employees in the case of transfer of undertakings.
- Civil liability of the members of the management bodies and of the experts for misconduct towards the shareholders of the company being acquired (Articles 20 and 21 of the Directive). The civil liability of the company's officers within the scope of Article 61 of the draft law is restricted to "losses caused to the company by their actions or inactivity".
- Nullity rules for merger (Article 22 of the Directive).
- Other operations treated as mergers (Articles 30 and 31 of the Directive).

Finally, it is worrying to detect that in two circumstances, the draft law refers to "Joint meeting of shareholders" [Art. 80(3) and Art. 81(3)] and does not envision therefore the consequences *ipso jure* and simultaneously of the merger[65].

[65] Article 19(1) of Directive 78/855/EEC:
A merger shall have the following consequences *ipso jure* and simultaneously:
(a) the transfer, both as between the company being acquired and the acquiring company and as regards third parties, to the acquiring company of all the assets and liabilities of the company being acquired;
(b) the shareholders of the company being acquired become shareholders of the acquiring company;
(c) the company being acquired ceases to exist.

8.3. Divisions and operations considered as equivalent

Division of JSC in the EU legislation is governed by Directive 82/891/EEC which makes the distinction between division by acquisition and division by the formation of new companies. This distinction is not reproduced in the draft law or elsewhere in other pieces of national legislation[66].

Observations made in the section 8.2 above on mergers apply *mutadis mutandis* on divisions as far are concerned:

- Drafting of the terms of division by the management bodies
- Publication of the draft terms of division
- Approval of a division
- Reports by the management bodies of each of the companies involved in the division
- Examination of the draft terms of division by independent experts
- Right of shareholders to inspect documents
- Rights of the employees of each of the companies involved
- Civil liabilities of the members of the management bodies and of the experts
- Nullity rules for divisions
- Publication of the division
- Date on which a division takes effect

In addition, we note that the draft law does not foresee issues corresponding to the rules laid down in the following articles of Directive 82/891/EEC:

- Article 20 (exemption from the approval by the general meeting of the company being divided)
- Article 23 (division under the supervision of a judicial authority)
- Article 24 (operations treated as divisions where cash payment exceeds 10%)

Moreover, we think rules on division should apply to the situation of "spinning-off" covered by the article 83 of the draft law[67].

8.4. Protection of the interests of creditors in case of merger or division

Article 13 of the Directive Merger and Article 12 of the Directive Division are implemented by Article 79(2) of the draft law as far as creditors of the company ceasing to exist are concerned. Regretfully, the situation of creditors of the acquiring company is not mentioned.

Similarly, Articles 15 of the Directive "Merger" and 13 of the Directive "Division" (protection of holders of securities other than shares to which special rights are attached) are mirrored in Article 77(4) of the draft law.

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[66] According to the SDLA Review 2006 on the state of play of the law approximation, the transposition of the Directive 82/891/EEC in the existing legislation would be limited to the transposition of Article 5(1) of this Directive in the Regulation approved by Decision No 221 of the State Commission for Securities and Stock Market of 30 December 1998.

[67] See Article 25 of Directive 82/891/EEC (operations treated as divisions where company being divided does not cease to exist).

By contrast, the protection of the debenture holders aimed at by Article 14 of the Directive Merger (same rights as other creditors except where the merger has been approved by them) is not reproduced in the draft law which never deals with the situation of debenture holders and mentions just once under Article 20 (placement of securities) that a JSC can issue bonds.

9. Conversion of JSC into another type of company

The draft law provides that the conversion of a private JSC into a public JSC and vice versa is not considered as a transformation [Art. 5(2)]. Consequently, the legal personality of the company would subsist. Unfortunately the draft law does not go further to detail the requirements applicable to this conversion and overlooks other kinds of conversion, for example, the conversion of the JSC into a Limited Liability Company (equivalent to a GmbH in Germany or a SARL in France).

10. Winding up and liquidation of the company

The draft law provides shortly for liquidation of JSC under Articles 85 and 86. The distinction between the winding-up of the company and its liquidation is not clearly established. To this end it has to be reminded that there could be an important lapse of time between the decision of winding up the company and the end of the liquidation. That is why the EU legislation requires the compulsory disclosure of the two situations (Directive 68/151/EEC) and, generally, the legislation in the EU Member States provides for a set of rules in respect of a number of key issues such as:

- Quality to represent the company towards third parties
- Mentions on the commercial papers of the company
- Restricted capacity to take new commitments for the company and continuation of on-going contracts
- Transfer of shares during the period of liquidation
- Responsibility to submit annual accounts and taxation returns
- Operations where the approval of the General Meeting is required
- Designation and fees of liquidators
- Civil and criminal liabilities of liquidators
- Interim payments to shareholders during the liquidation
- Sales of assets to related-parties of the liquidators of former company' officers
- Insolvency proceedings during the period of liquidation
- Approval of the termination of liquidation and official publication

The draft law does not offer so many safeguards. It is to the General Meeting to decide on all matters and to delegate the same powers to a "Liquidation Commission" without legal requirements imposed by the law.

Paradoxically, where the draft law is more detailed, it is to insert provisions on the priority ranking for the distribution of assets that mostly duplicate the provisions already existing in Article 31 of the Civil Code of Ukraine. Instead of this partial duplication, it would have been expected provisions on the articulation of voluntary liquidation of JSC and the possible insufficiency of assets to pay all creditors. In this situation the law on insolvency would apply[68].

[68] Law No 2343 of 14 May 1992 on Restoring a Debtor's Solvency or Recognising its Bankrupt sets out as well a preference order for the payment of creditors after the sale of assets resulting from the liquidation.

11 Entry into force, amendments to existing legislation and transitional measures

Chapter XVII of the draft law consists of a series of rules that deal with the amendments to the existing legislation, the entry into force of the law and the transitional measures.

Provisions repealed or added in the existing legislation seek for consistency or the overall legal framework applicable to JSC. At this stage, it is not possible to ascertain whether this objective has been achieved. Further scrutiny is needed.

Other amendments define new criminal offences worded very briefly:

- False information on the financial and economic situation of the company
- Default in providing annual report ("review of annual reports", in the text)
- Breach of rules on the organisation of General Meetings, designation of the "managerial bodies, payment of dividends in due time, issue of new shares, procedure applicable to major transactions, public offer of shares without registration
- Undue influence on the vote of a worker- shareholder at the General Meeting

There are also administrative penalties in respect of law on securities.

Compared with the description of offences for non-compliance of key corporate rules in the legislation of the EU Member States, it is obvious first that the panorama of offences in the draft law is quite limited. Moreover, it is a basic rule for the protection of fundamental freedoms that criminal law is interpreted strictly. Therefore, offences should be defined extensively in all their components and without ambiguity.

The entry into force of the law six months after its publication is alleviated by the adjournment of some provisions which will enter into force gradually. Deadline to bring into conformity the charters of the existing JSC is five years as from the date of the entry into force of the new law but, even in this case, the mandatory provisions of the law apply immediately.

The main originality of the draft law is to specify that private JSC (closed) incorporated before the entry into force of the new law will remain governed by the old legal framework. This situation might be indefinite, as least insofar the company in question does not increase its share capital and does not issue new shares[69].

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[69] The wording of this exemption would deserve to be clarified. It is difficult to determine whether the expressions "increase in capital" and "issue of new shares" have to be interpreted as a cumulative condition or cover two individual situations.

II –Functional appraisal of the draft law on JSC

Across this Part II of the report, we analyse how the draft legal framework impacts the creation of a favourable environment for enterprises and meets the political and economic objectives of the reform.

This assessment is carried out with regard to the following objectives:

- To which extent the draft law on JSC represents a sound basis for uniform application and enforcement?
- To which extent the proper balance of the interests of stakeholders may create optimum conditions for the pursuit of the objectives of the enterprise?
- To which extent the draft law is a step forward to establish closer links with the EU and to have a stake in the Internal Market of the EU?
- To which extent the draft law on JSC is adapted to a wide range of enterprises?

1. Grounds for uniform application and enforcement

Risks with regard to the effectiveness expected of the draft law after its entry into force may result from various factors:

- Weak implementing measures in the secondary legislation or in the self-regulatory framework (Charter, Code of Corporate Governance).
- Lack of legal certainty due to legal vacuums, ambiguity of certain provisions, inconsistency of certain provisions within the overall legal framework.
- Inoperability of some provisions or implementation of some provisions becoming so burdensome that risks of non-compliance would arise.

The challenge is to make the law workable, to ensure its uniform application and its enforcement by the courts. That is the predictability needed by the business community to use the legal form of JSC.

Inclusive framework

Firstly it has to be stressed that the draft law does not represent an inclusive framework for private and public JSC.

Corporate interferences in group of companies are governed by the draft law indirectly and are limited to the framework of mergers and acquisitions. A number of other issues (distinct from taxation or accounting issues) where the concept of group of company has an importance are passed over in silence[70].

A wide place is given to the charter of the company or by-laws subordinate to the charter.
This flexibility is welcome since the function of the legal framework is only to mandate minimum requirements.

[70] As far as the EU legislation is concerned, see, for example, Article 24(a) of Directive 77/91/EEC (subscription, acquisition and holding of shares by a group of companies) that is not reflected in the draft law.
In the legislation of the EU Member States, specific corporate rules apply to groups of companies.

The point is that the draft law does not explore some fields where mandatory requirements would be necessary. It is sufficient to see in this respect that a number of situations, where the EU law provides for minimum mandatory requirements, are not regulated by the draft law. Likewise it is observed that the draft law does not tackle issues on the conversion and liquidation of JSC which, normally, are subject to mandatory requirements in the legislation of the EU Member States.

Secondary legislation

The draft law empowers the State Commission of Securities and Stock Market to enact implementing provisions on the following:

- Procedure to exercise the right of pre-emption where shares can be sold by shareholders to third-parties [Art. 6(2)].
- Procedure to take a corrective action in case of losses of subscribed capital [Art. 13(3)].
- Procedure for the cancellation of shares redeemed by the company [Art. 16].
- Procedure for the increase or reduction of share capital [Art. 13(4)], [Art. 14(1)], [Art. 15(1).
- Procedure for the consolidation or subdivision of shares [Art. 17(5)].
- Procedure for the use of the legal reserve [Art. 18(2)].
- Procedure for the conversion of liabilities into shares and stocks [Art. 20(2)]
- Procedure on the provision of information to the shareholders before General Meetings [Art. 35(2)].
- Listing of supporting documents to qualify as a shareholder authorised to participate in a General Meeting [Art. 39(4)].

We may imagine that despite the wording of the law, the rules to be enacted by the State Commission of Securities and Stock Market will include not only procedural rules but also substantive rules.

Furthermore, the State Commission of Securities and Stock Market Securities is the notified body to receive information on the acquisition of a significant block of shares [Art. 62 and 63] and changes in the agenda of the General Meetings are communicated to this institution [Art. 37(7)].

All those implementing measures give credibility to the enforceability of the law.

Legal certainty

Since the draft law does not consolidate sufficiently[71] provisions existing in other pieces of national legislation risks of contradicting provisions or provisions which would not receive the same interpretation may occur. We note, for example that the prohibition of the financial support of the company for the purchase of its shares by third-parties is regulated twice; first, in the law of 23 February 2006 on Securities and Stock Market and a second time, in the draft law. Similarly, requirements concerning the content of the charter and conditions of compulsory disclosure of certain information are not harmonised between the draft law and the law of May 2003 on State Registration of Legal Entities.

Moreover, ambiguities or confusions in the text of the draft law, mentioned in the Part I of this report, might have serious consequences where they give room for diverging interpretation (transferability of shares, definition of major transaction, notion of right of pre-emption, notions of mergers and divisions).

Operability of the law

Some provisions of the draft law do not seem practicable without further adjustments:

- Definition of minimal capital lying on a variable element (minimum wages)
- All public JSC that should be listed at the Stock Exchange Market
- Quorum required for the second call of the General Meeting

Enforceability

Three clear measures for the enforcement of the law are set out in the text:

- The State Commission of Securities and Stock Market is empowered to refer a case to a court where rights of shareholders are disregarded by a resolution of the General Meeting [Art. 48(2)].
- Breach of duty in respect of disclosure of information is subject to compensation for damages and/or annulment of the transaction by courts (Art. 70).
- Joint civil liability of all members of Supervisory Board, Executive Body and Audit Committee to compensate "losses caused to the company by their actions or inactivity" (Art. 61).

As said before, damages sustained by shareholders or creditors are not addressed by the draft law.

In addition, what is crucially missing is a general provision, or a set of provisions at the appropriate place in the text, which would entitle any shareholder or creditor to apply to court to obtain a remedy in case of default made in complying with provisions of the law or of the charter. The absence of such a judicial remedy impedes the enforceability of the law.

Apart from the civil remedies, the draft law defines new criminal offences and administrative penalties (Chapter XVII). Regretfully, offences are limited in their scope and vague definitions

[71] Chapter XVII of the draft law.

give room to arbitrary. In the legislation of the EU Member States, cases of public prosecution, or cases of administrative offences target a larger number of non-compliant behaviours.

2. Contribution to the existence of a functioning market economy

Existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union is one of the Copenhagen Criteria which has been taken on board by the Ukrainian Government to get closer to the EU.

Performances of enterprises in a competitive environment are affected by the legal structure of enterprises. Attracting investors or securing loans is the only way for enterprises to mobilise sufficient capital to ensure their development and to resist to competitors. How rights and responsibilities of the corporate bodies are organised influence directly the confidence of the financial partners and creditors.

Against the background of some key criteria drawn on the OECD Principles of Corporate Governance (2004)[72], we will try to determine to which extent the draft law is providing the adequate legal framework to reinforce the market economy in Ukraine.

Protection and facilitation of the exercise of shareholders' rights

In the normal course of the company's activity, the voting rights of shareholders[73], as laid down in the draft law, meet the objectives of good corporate governance and they are almost fully in line with the requirements of the Proposal for a Directive on the exercise of voting rights by shareholders.

Where, it comes to issues of alteration of capital or in case of merger and acquisitions, voting rights of shareholders are also respected but the information of shareholders before the approval of the operations in question would deserve some improvement.

Equitable treatment of shareholders

Foreign investors are not discriminated. On the contrary, companies in which 100% of the shares are held by foreigners are authorised to organise General Meetings abroad. Nevertheless, voting by correspondence is not yet recognised.

Likewise, minority shareholders are granted significant rights corresponding to good corporate governance (for example, the right to put items on the agenda of the General Meetings and the right to request an independent audit) but, as regards listed companies, more transparency should be sought through the notification of a greater number of thresholds on the proportion of shares held by shareholders.

Compulsory redemption of shares of minority shareholders, where certain conditions are met, intends to grant astonishing rights to minority shareholders but we think the draft law does not

[72] Almost the same criteria have been used in a "Comparative Study of Corporate Governance Codes relevant to the European Union and its Member States" commissioned by DG MARKT of the European Commission in January 2002, (Final Report & Annexes, by Weil, Gotshal and Manges in consultation with EASD and ECGN).

[73] The exercise of voting rights includes the following: calling of the AGM, notice of the AGM, information provided to shareholders before the AGM, items on the agenda of the AGM, participation in the AGM (with possibility of proxy voting), transparency of vote and results of the vote.

address this issue in the proper context. Compulsory redemption of shares that may exist in the EU legislation or in the legislation of the EU Member States relate to other situations than those envisaged in the draft law and they are never liable to put at risk the financial sustainability of the enterprise.

Structure, responsibilities and accountability of corporate bodies

Sections of the draft law dealing with structure and responsibilities of corporate bodies mirror a wide range of good corporate practices. Worth noting, in particular, the openness to the participation in meetings of Supervisory Board and Executive Body and the circulation of the information between the Supervisory Board and the Executive Body.

Accountability of supervisory and managerial bodies and internal control system are also well treated, except the liability for damages which is limited to damages sustained by the company.

There is still room for more detailed provisions in the charter of the company or in a voluntary Code of Good Governance to give a more muscular picture of good governance practices that will tackle in particular the following issues:

- Independence of the Supervisory Board and its capacity to have an objective assessment of the corporate affairs and the performance of the enterprise.
- Remuneration and compensation schemes of the members of Supervisory Board and the Executive Body.
- Composition of the Audit Committee and other measures to strengthen the independence of the statutory auditor.

Protection of the interests of stakeholders – creditors and employees

Creditors' rights in the case of reduction in the subscribed capital or in the cases of mergers and acquisitions are duly considered by the draft law, although some shortcomings would deserved to be addressed to reach the level of protection existing in the EU.

There are in particular debenture holders which represent a very significant group of creditors in public JSC and that the draft law ignores entirely.

Worth noting that despite the broad inspiration from the German model to design the structure and responsibilities of corporate bodies (two-tier board system) the draft law does not grant voting rights to employees participating in the AGM or in Supervisory Board meetings. Involvement of employees in the corporate bodies differs considerably among the EU Member States. Sometimes, the representatives of the workforce are granted an advisory voice, sometimes they elect some members of the supervisory body and there are also other forms of participation such as plans for employee stock ownership.

Considerations for employees in the draft law derive from the following provisions:

- Article 27: influence exercised on the vote of employees where employees are also shareholders.
- Article 33(1): a delegate of the body that represents the employees may participate in General Meetings
- Article 53(1): representatives of trade unions or other representatives of workers that have conclude a collective bargaining may participate in meetings of the Supervisory Board.
- Article 57(3 and 4): a delegate of the body which represents collectively the workers has the right to participate in meetings of the collegial Executive Body and, on request, minutes of the meetings are made available to him/her.

It is obvious that the terminology used to qualify the representation of employees in the enterprise is confused and not yet definitely settled. So it is because the labour law is not very advanced on this issue. That may explain also why the rights of the employees in the case of merger or division of companies which are granted by the Directive "Merger" and the Directive "Division" by reference to the Directive 2001/23/EC (transfers of undertakings)[74], are not recognised in the draft law or elsewhere in the national legal framework.

[74] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses.

Code of Corporate Governance

No allusion to a Code of Corporate Governance is made in the draft law. It is not either possible to find in the draft law any mention of corporate governance statements in the annual reports of the company[75].

Conclusion

It flows from the considerations exposed in this section dedicated to the contribution of the draft law to the existence of a functioning market economy that tangible efforts have been made to address rules of good corporate governance but they have been limited in their focus.

3. EU compatibility

Despite the "best endeavour clause" of Article 51 of the PCA and the priorities set-out in the EU-Ukraine Action Plan, it appears that the draft law on JSC have given little consideration to the approximation of the Ukrainian legislation to that of the EU.

Moreover, it transpires from the articulation of provisions and definitions in the draft law, that where there are some occurrences that requirements of the EU legislation are met, it is more a coincidence than the result of the willingness to approximate the Ukrainian legislation to the EU legislation.

It would have been desirable to achieve at least conformity with the two first European Directives on company law:

- Directive 68/151/EEC on public disclosure of information applicable to all companies;
- Directive 77/91/EEC on the formation, maintenance and alteration of the capital of public JSC.

The two Directives are prioritised as "key measures- stage I" in the "White Paper on the Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union"[76]. They are essential because "they guarantee the necessary protection for creditors and investors, both local or foreign who want to enter into contact with companies incorporated in the associated countries".

The alignment of the Ukrainian legislation to the Directive 68/151/EEC is almost achieved thanks to the law of 15 May 2003 on State Registration of Legal Entities and Natural Persons-Entrepreneurs but the draft law would have been the occasion to achieve full compatibility.

A number of requirements of Directive 77/91/EEC are also reflected in the draft law. Nevertheless, should it be some kind of transposition, often the related provisions of the draft

[75] The Directive 2006/46/EC has introduced amendments to the Directives on corporate accounting. Pursuant to those amendments, the corporate governance statement is made mandatory for listed EU companies. The corporate governance statement is included in a specific section of the annual report that accompanies the annual accounts. It contains at least reference to the corporate governance practices applied (voluntarily or not), the extent to which the company departs from a corporate governance code and the reasons for doing so, a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process.

[76] COM(95) 163 final of 10 May 1995.

law are a watering-down version of parallel requirements in the EU legislation and serious discrepancies subsist[77].

The gaps between the provisions of the draft law and the requirements of the EU legislation is still wider as far are concerned mergers (Directive 78/855/EEC) and divisions of JSC (Directive 82/891/EEC). Lastly, it seems that the acquisition of a significant block of shares has not been seen as an area of application of the Directive 2004/25/EC on takeover bids. Consequently the Directive 2004/25/EC has been reflected to a very limited extent.

4. Suitability for various categories of enterprises

It has to be observed first that the Ukrainian enterprises that will adopt the structure of JSC will be more vulnerable that their counterparts in the EU in respect of consequences of loss of the subscribed capital. As remarked in the Part I (section 7.1) of this report corrective measures in the EU legal framework are only envisaged in case of serious loss, while in the Ukrainian legal framework, it is any loss.

Secondly, the new legal framework does sound to be friendly for SMEs. Apart from the requirement that the share capital may be held by one person, shares have to be fully paid up at the time of their subscription. For example, this requirement would no be suitable for a start-up enterprise with activities in the field of new technologies. Such an enterprise is often based on the development of an innovation by a small group of young founders with a limited access to capital.

In the same vein, it is rather counter-productive for the creation of wealth and jobs to set out identical conditions of minimum capital for public and private JSC.

Thirdly, there is an assumption that, even a SME composed of one shareholder would need to appoint a Company Secretary. It is expected that this provision which would hamper the cash flow of small enterprises without a real corporate usefulness, as far as SME s are concerned, will be reshuffled in the text of the draft law.

In total, the differentiation among private and public JSC is limited to the following provisions:

Public JSC

- Transferability of shares without consent of other shareholders (supposedly)
- Determination of the market value of securities
- Placement of shares subject to a certificate of registration of the first issue of shares
- Members of the Supervisory Board and Audit Committee elected through the system of cumulative vote
- Notification of the agenda of the General Meeting to the stock-exchange where the company is admitted to trade securities.
- Mandatory use of ballot papers for exercising voting rights at the General Meetings with requirements on their content
- Notification of takeover offers
- Website to disseminate information on corporate affairs

[77] See, in particular, the ceiling of 20% concerning the maximum amount of its own shares that the company is authorised to acquire in accordance with the draft law, instead of 10% in the EU legislation.

- Notification to the stock-exchange of resolutions to terminate the company through merger and division.

Private JSC: option to introduce in the charter a clause authorising the exercise of right of pre-emption in case of transfer of shares.

Differentiation of the rules between companies merely lies on the criterion of the shareholders' number:

- More than 10 shareholders: compulsory existence of the Supervisory Board
- 25 shareholders or less: simplification of the procedure to adopt certain decisions [Art. 41(3, 2nd paragraph)]
- More than 100 shareholders:
    - Commission in charge of the scrutiny of polls composed of 3 members at least
    - Compulsory setting-up of an Audit Committee
    - Compulsory assessment by an independent expert of the terms of mergers and divisions of companies
- 100 to 1000 shareholders: Supervisory Board composed of at least 5 members
- Above 1000 shareholders: Supervisory Board composed of at least 7 members Above 10,000 shareholders: Supervisory Board composed of at least 9 members
- 1000 shareholders and over: mandatory redemption of shares where this right is open in the draft law

The facility provided to JSC to be run by one single shareholder does not establish an adequate corporate framework for SMEs. This desirable legal framework with its own safeguards and corporate rules should be similar to that one developed in Germany[78] or in France[79] and probably in other European countries. The approach followed by those EU Member States has been to extend to small JSC the provisions set out for Limited Liability Company in relation to the transposition of the Directive 89/667/EEC on single-member private limited-liability companies.

To conclude on the way the requirements of the draft law are adapted to the needs of enterprises, it could be said "too little for listed companies, too much for SMEs".

Conclusion

A law on JSC is always a masterpiece of the national legal framework in countries of market economy. This key piece of legislation is also always articulated with other pieces of national legislation especially in the fields of securities, taxation, accounting and labour. In addition, it is natural for a law on JSC to take stock of other types of companies at least to anticipate the conversion between JSC and other types of companies.

In this regard, despite some mentions of other pieces of national legislation, the draft law looks like a piece of legislation rather disconnected from the overall legal framework in Ukraine.

The cause may be attributed, at least partially, to the process of legal drafting in which the Ministry of Justice was not the leading authority.

[78] Law of 2 August 1994 on small JSC and simplification of rules on securities.
[79] Law of 30 January 1994 on simplified JSC.

A law on JSC is not a technical regulation. On the contrary, it one of the most sophisticated exercise of legal drafting in which the drafters have to handle a number of legal concepts in close relation with the basic provisions of the Civil and Economic Codes. Having a look retrospectively to the situation in new EU Member States during their period of accession, we note that the "Chapter of the Acquis" "Company law" was under the remit of the Ministry of Justice of each candidate country.

Beside the shortcoming above, it has been observed that the draft law had not sufficiently taken account of the EU legislation on company law, each time it would have been appropriate and where the Ukrainian economy would have not suffered from the approximation of the legislation. Here, maybe there is some misunderstanding on the role of the law approximation. The issue is not to perform a formal exercise. The EU legislation is not a creation *ex-nihilo*. It has been designed on the models already functioning in EU Member States. The issue is to take advantage of this considerable experience.

Failing to introduce sufficiently, in the national legal framework, widely recognised practices experienced satisfactorily in a market economy, the draft law on JSC does not seem in position to ensure mutual trust between Ukrainian enterprises and trading or investing partners. As it stands now, it cannot be considered therefore as a core building block of the market economy in Ukraine.

One could say that the very purpose of the new law on JSC is to allow the 18 million shareholders of Ukrainian JSC getting some benefits from the massive privatisation of companies during the last decade. That is a legitimate objective but it is not reasonable to think that another future law on JSC could govern JSC for foreigners. That would be a discriminatory approach not compatible with WTO requirements. Furthermore, it would not be realistic to regulate JSC with three different legal frameworks (old JSC, JSC governed by the current draft law, future JSC law designed to attract foreign investors).

ANNEX I

Documents taken into consideration for the assessment of the draft law on JSC

Community legislation in force

- First Council Directive of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (68/151/EEC)

- Second Council Directive of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (77/91/EEC) - (including amendments by Directive 2006/68/EC of 6 September 2006)

- Third Council Directive of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies (78/855/EEC)

- Sixth Council Directive of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies (82/891/EEC)

- Twelfth Council Company Law Directive of 21 December 1989 on single-member private limited-liability companies (89/667/EEC)

- Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids

- Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

- Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings
- Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC

- Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities

Preparatory Acts

- Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC - COM(2005) 685 final of 05.01.2006

Other sources

- French Company law 2007 (Francis Lefebvre)
- Companies Act 2006 (UK)
- German Corporate Governance Code as amended on 12 June 2006
- OECD Principles of Corporate Governance (2004)
- JSC in American Law (André TUNC)
- JSC in the UK (André TUNC)
- Comparative Study of Corporate Governance Codes relevant to the European Union and its Member States, on behalf of the European Commission, Internal Market Directorate General, Final Report & Annexes, by Weil, Gotshal and Manges in consultation with EASD and ECGN, January 2002

ANNEX II

OECD Principles of Corporate Governance (2004)

Principles and sub-principles extracted from the official sources (OECD)

I) Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

A. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

B. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

C. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

D. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

II) The rights of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

A. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.

B. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

2. Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

3. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated.
Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

4. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

2. Anti-take-over devices should not be used to shield management and the board from accountability.

F. The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

1. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

2. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

G. Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

III) The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same series of a class should be treated equally.

1. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

2. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.

3. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

4. Impediments to cross border voting should be eliminated.

5. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

IV) The role of stakeholders

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. Performance-enhancing mechanisms for employee participation should be permitted to develop.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

E. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

V) Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Company objectives.
3. Major share ownership and voting rights.
4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.
5. Related party transactions.
6. Foreseeable risk factors.
7. Issues regarding employees and other stakeholders.
8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.

B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.

C. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.

D. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.

E. Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

F. The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

VI) The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should apply high ethical standards. It should take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
5. Ensuring a formal and transparent board nomination and election process.
6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
8. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective independent judgement on corporate affairs.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.

3. Board members should be able to commit themselves effectively to their responsibilities.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.